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China, Peoples Republic of

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Report Highlights: Report Highlights: China's raw milk production is forecast to increase 25% during 2005 due to continued strong demand from consumers for dairy products. Despite the strong demand for imported live dairy cows and bovine genetics, China has not lifted its ban on imported US and Canadian bovine products due to the BSE cases in those countries. Though on September 28, 2004, China lifted the ban on imported semen, embryos and protein-free tallow from BSE-affected countries, final import approval is contingent on negotiating and signing bilateral protocols. China's direct imports of US dairy products during CY2004, led by whey products, are forecast to increase 38 percent to approximately $55 million.

Includes PSD Changes: Yes
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Executive Summary

China's dairy industry is growing rapidly in response to rising consumer demand for milk and yogurt products. Total raw milk production during 2005 is forecast to grow 25 percent. However, the pace of growth is forecast slower than the pace of 2003 due to production cost increases and production constraints.

The shortage of raw milk supply is the weakest part of the Chinese dairy industry. Unlike developed countries, China's raw milk increases have mainly resulted from dairy herd expansion. Milk output per cow has not changed much in the last ten years. China's dairy constraints include the deterioration of natural grasslands, the decrease in arable land for feed grain production, serious water shortages and the lack of high quality cows. As large companies carve-up milk sources and herd sizes become saturated, genetic improvements will become more critical to increase raw milk output.

On September 28, 2004, China lifted its ban on imported bovine semen, embryo and protein-free tallow from BSE countries. However, actual imports are contingent on negotiating and signing bilateral import protocols. Once imports of these products resume, strong demand, limited domestic supplies and reduced tariffs will lead to significant import levels of breeding cows, genetic materials and dairy products during 2005 and beyond.

China's imports of whole fat milk powder for 2005 are forecast to increase 24 percent from 91,000 MT to 113,000 MT. Imports of nonfat powder for 2005 are forecast to increase 23 percent from 81,000 MT to 100,000 MT. The increase is due to increased demand from high-end consumers and also less confidence in domestic milk powder caused by 12 cases of enfant death after taking bad quality milk powder.

Australia and New Zealand are the primary beneficiaries of China's growing demand for imported breeder stock and livestock genetics in 2004. China suspended imports of live cattle and genetic materials from the United States due to the single BSE case in December 2003.

China's signals to lift the ban on genetic materials will eventually provide new opportunities for US dairy products. The United States is also still the largest whey supplier to China, accounting for one-third of China's direct imports in volume from January to August 2004. At the current pace, imports of US whey will reach $37 million in CY2004. US whey exports to China through Hong Kong increased rapidly after the SARS outbreak.

China's exports of fluid milk for 2005 is forecast to fuel 35 percent due to export market increase in Hong Kong and Macaw. Whole-fat milk powder exports in 2005 are forecast to increase 20 percent due to increased demand for low-end, cost-competitive products.

Post revised the cow-in-milk numbers upwards from 3.4 to 4.4 million head in 2003 and from 3.6 to 5.4 million head in 2004 in the PS&D table. The changes are based on information from China's Ministry of Agriculture (MOA) and the China Dairy Association (CDA). Although there is no official announcement of cow-in-milk numbers, MOA and CDA experts generally believe that currently 50-55 percent of the total cow inventory is in milk and annual averaged cow yield is 3.5-4 MT. Also, they think NSB's cow number in the Rural Statistics Yearbook for 1997 is too low.

NSB changed its statistic methods and wording in 2004 to announce only solid products and fluid products. The industry complains for no further breaking down.

Milk production continues to grow, but the pace slows due to cost increases

China's total raw milk production for 2005 is forecast to grow 25 percent from 2004 to 28 MMT, the same year-on-year raw milk production increase from 2003 to 2004. The pace of cow milk production growth is faster than other milks. The National Statistics Bureau (NSB) data shows that the "other milk" share has dropped from 14 percent in 1996 to 5 percent in 2003 because Chinese consumers believe cow milk is more nutritious. This trend is expected to continue in China.

According to the MOA, cow milk production is more and more concentrated in the "advantageous milk production regions" designated by the Chinese Government. The top five producing areas are Inner Mongolia, Heilongjiang, Hebei, Shandong and Xinjiang, accounting for 60 percent of China's total cow milk production.

As for the processed dairy industry, solid production in 2003 increased 33 percent to 1.4 million MT and fluid product increased 59.9 percent to 5.8 MMT. Solid production in the first six months of 2004 increased 36 percent, and fluid product increased 35 percent over the same period of 2003. Strong demand and lagging raw milk production supplies have pushed cow prices up from RMB 6,000 ($1 = RMB 8.27) some years ago to RMB 20,000 now, and some times cows are not even available at this price. The average price for raw milk was RMB 1.69 per kg in 2002, RMB 1.81 in 2003 and RMB 1.92 in the first six months of 2004, surpassing the averaged prices in Russia, Australia and New Zealand in 2003 (converted into RMB). This rising milk prices explains why imports of dairy products and live cows have risen since last year.

Although dairy production costs have gone up considerably, prices of domestic processed milk products in retail markets have remained stable. Actually, the dairy industry is still fragile because dairy products are not traditionally consumed in China. After several years' market cultivation by the industry and the Government, dairy consumption has gradually become prosperous. If dairy product prices rise beyond consumers' acceptance, many consumers may switch to other nutritious products. Therefore, large dairy companies are trying to keep prices stable. As a result, profit margins are smaller, thus forcing smaller companies out of the business. The China Dairy Industry Association (CDIA, for processed products) indicated that 158 out of 584 processing plants lost profit in 2003, higher than that of 2002.

In the previous annual report, FAS Beijing explained that China's large dairy companies and foreign joint ventures are battling to carve-up domestic milk sources, leaving small and medium-sized companies to resort to more use of imported milk powder. Although the national food labeling standard was revised recently, there is no enforcement of the requirement to state that "fluid milk blended with powdered milk" as widely discussed last year. This flexibility will encourage small and medium sized plants to continue to use imported milk powder for dairy product manufacturing.

China joined the World Holstein Association in 2004 in order to improve dairy genetic stocks. When these efforts will have an impact is unknown. There are only 3 million head of Holstein cows in China. The remainder are crossbred between local labor cows and Holsteins or other breeds. Before 2000, farmers did not crossbreed because the dairy did not earn much money. When dairy started getting prosperous, farmers and companies rushed to import large breeding cows. As a result, many low quality cows also entered China to be used as milking cows. Farmers hold their old cows even after 9-10 calves instead of replacing them with new generation after 4-5 calves. No matter how low the milk production, they are all included in the end-of-year inventory number. These factors explain why the cow inventory increased so fast.

Feed is another major limitation for China's dairy industry. According to the National Development and Reform Commission (NDRC), arable land decrease was 6 million hectares (ha) during 1996 to 2003. Fourteen percent of this area was used for none-agricultural construction, 62 percent was turned into forestry or forage grass that has benefited cattle industry and the other was for usage adjustment due to natural disasters. However, as China's grain production decreased, the Government changed the policy to slow down the pace of turning poor arable land for other usage including forage.

China approves import of semen/embryos from BSE countries (including the US), but contingent on negotiating and signing quarantine protocols

Although China has lifted its ban on semen and embryo products from BSE countries (see translation below of AQSIQ's website announcement) on September 28, 2004, each country must then negotiate an import quarantine protocol with AQSIQ—despite OIE standards that recommends trade be resumed without conditions since the OIE considers bovine genetic materials as safe. It remains uncertain when China and the US will reach agreement on imported US bovine semen and embryos.

(FAS Beijing Translation)

Announcement of the Ministry of Agriculture and the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic of China
No. 407

In order to prevent BSE from entering and protect livestock safety and human health of China, the Ministry of Agriculture and the General Administration of Quality Supervision, Inspection and Quarantine have consecutively published announcements prohibiting imports of relevant animals and their products from BSE countries or regions. In accordance with the latest scientific evidence and recommendations of the International Animal Health Code of the OIE, the ban on importation of the following products associated with BSE will be lifted immediately.

Cattle semen, embryo (the exporting country should demonstrate that the embryo complies with the stipulations of International Embryo Transplantation Association), non-protein tallow (does not contain protein and content of infusible foreign matters no more than 0.15%) and their products, calcium phosphate dibasic made from bone (does not contain protein or tallow), industrial gelatin and collagen processed completely from leather or hide, filming gelatin, non-ruminant origin feed and products (except for products prohibited for use by the exporting country or region).

The aforementioned products must comply with relevant laws and regulations of China, and non-compliant products are not allowed for entry.

It is therefore announced as such.

September 28, 2004

(END OF ANNOUNCEMENT 407)

Urban, wealthier consumers continue drinking-up milk products, but the pace of growth less than expected

According to the NSB, per capita urban residents consumed 2.1 kg of dairy products (conversion rate of powdered for raw milk is 7 kg), an increase of 4.5 percent over the same period of 2003. Of this, fresh milk was 1.5 kg, up 3.3 percent, powdered milk was 0.047 kg, down 6 percent, and yogurt was 0.23 kg, up 35.3 percent. During 2004 powdered milk consumption was impacted by the 12 infant deaths in Anhui Province due to drinking poor quality (low levels of protein) powdered milk. As a result of this incident, large dairy companies are in a better position to increase sales in the future.

United States the largest whey supplier to China

China's whey imports for 2005 are forecast to increase 10 percent. Although the United States has remained the largest supplier of China's why imports market in the last few years, its exports during January-August 2004 decreased eight percent over the same period of 2003 due to higher prices than its competitors. However, US export value only dropped half a percent. Also, part of the lost shared in volume was covered by tripled US exports through Hong Kong.

China's import market for cheese and butter is dominated by New Zealand and Australia. Imports during January-August 2004 surged 73 percent and 32 percent respectively. This trend will continue in the next couple of years because China does not produce much cheese due to low domestic consumption. Imports of high quality cheese are mainly for high-end restaurants and hotels. The US has started cutting into China's cheese import markets due to the marketing efforts of the US Dairy Export Council.

China's milk powder exports forecast to increase 20 percent in 2005

China's exports of fluid milk in 2005 are forecast to increase 37 percent from 27,000 MT to 50,000 MT, while whole fat milk powder exports will increase 20 percent from 24,000 to 29,000 percent. Fueled exports are driven by export market increase in Hong Kong and Macaw. Beside traditional export markets like Hong Kong and Macaw, China has developed new markets like the US and Taiwan with a very small market share of fluid milk and whole-fat milk powder. In general, China imports high-end dairy products and exports lower-end ones.

PSD Table

Country China, Peoples Republic of

Commodity Dairy, Milk, Fluid

(1000 HEAD)(1000 MT)

	2003 USDA Official [Old]	Revised Post Estimate [New]	2004 USDA Official [Old]	Estimate Post Estimate [New]	2005 USDA Official [Old]	Forecast Post Estimate	UOM [New]
Market Year Begin		01/2003		01/2004		01/2005	MM/YYYY
Cows In Milk	3417	4466	3690	5466	0	5600	(1000 HEAD)
Cows Milk Production	15550	17463	18505	22052	0	27790	(1000 MT)
Other Milk Production	1120	1024	0	1055	0	1090	(1000 MT)
TOTAL Production	16670	18487	18505	23107	0	28880	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	6	3	6	3	0	3	(1000 MT)
TOTAL Imports	6	3	6	3	0	3	(1000 MT)
TOTAL SUPPLY	16676	18490	18511	23110	0	28883	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	28	27	28	37	0	50	(1000 MT)
TOTAL Exports	28	27	28	37	0	50	(1000 MT)
Fluid Use Dom. Consum.	6916	7661	8299	10315	0	13606	(1000 MT)
Factory Use Consum.	9732	10802	10184	12758	0	15227	(1000 MT)
Feed Use Dom. Consum.	0	0	0	0	0	0	(1000 MT)
TOTAL Dom. Consumption	16648	18463	18483	23073	0	28833	(1000 MT)
TOTAL DISTRIBUTION	16676	18490	18511	23110	0	28883	(1000 MT)
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0	(1000 MT)
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0	(1000 MT)

PSD Table

Country China, Peoples Republic of

Commodity Dairy, Dry Whole Milk Powder

(1000 MT)

	2003 USDA Official [Old]	Revised Post Estimate [New]	2004 USDA Official [Old]	Estimate Post Estimate [New]	2005 USDA Official [Old]	Forecast Post Estimate	UOM [New]
Market Year Begin		01/2003		01/2004		01/2005	MM/YYYY
Beginning Stocks	0	0	0	0	0	0	(1000 MT)
Production	606	750	640	760	0	798	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	110	91	150	113	0	145	(1000 MT)
TOTAL Imports	110	91	150	113	0	145	(1000 MT)
TOTAL SUPPLY	716	841	790	873	0	943	(1000 MT)
Intra EC Exports	0	0	0	0	0	0	(1000 MT)
Total Exports	21	20	21	24	0	29	(1000 MT)
TOTAL Exports	21	20	21	24	0	29	(1000 MT)
Human Dom. Consumption	695	821	769	849	0	914	(1000 MT)
Other Use, Losses	0	0	0	0	0	0	(1000 MT)
Total Dom. Consumption	695	821	769	849	0	914	(1000 MT)
TOTAL Use	716	841	790	873	0	943	(1000 MT)
Ending Stocks	0	0	0	0	0	0	(1000 MT)
TOTAL DISTRIBUTION	716	841	790	873	0	943	(1000 MT)
Calendar Yr. Imp. from U.S.	2	2	0	0	0	0	(1000 MT)
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0	(1000 MT)

PSD Table

Country China, Peoples Republic of

Commodity Dairy, Milk, Nonfat Dry (1000 MT)

	2003 USDA Official [Old]	Revised Post Estimate [New]	2004 USDA Official [Old]	Estimate Post Estimate [New]	2005 USDA Official [Old]	Forecast Post Estimate	UOM [New]
Market Year Begin		01/2003		01/2004		01/2005	MM/YYYY
Beginning Stocks	0	0	0	0	0	0	(1000 MT)
Production	73	83	75	71	0	70	(1000 MT)
Intra EC Imports	0	0	0	0	0	0	(1000 MT)
Total Imports	50	51	65	69	0	88	(1000 MT)
TOTAL Imports	50	51	65	69	0	88	(1000 MT)
TOTAL SUPPLY	123	134	140	140	0	158	(1000 MT)
Intra EC Exports	0	1	0	2	0	3	(1000 MT)
Total Exports	0	0	0	0	0	0	(1000 MT)
TOTAL Exports	0	1	0	2	0	3	(1000 MT)
Human Dom. Consumption	123	133	140	138	0	155	(1000 MT)
Other Use, Losses	0	0	0	0	0	0	(1000 MT)
Total Dom. Consumption	123	133	140	138	0	155	(1000 MT)
TOTAL Use	123	134	140	140	0	158	(1000 MT)
Ending Stocks	0	0	0	0	0	0	(1000 MT)
TOTAL DISTRIBUTION	123	134	140	140	0	158	(1000 MT)
Calendar Yr. Imp. from U.S.	0	2	0	6	0	10	(1000 MT)
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0	(1000 MT)

Tariffs on Dairy Products, Effective January 1, 2004

		General	MFN	V.A.T	Effective Rate (MFN & VAT) 1/
Fluid Milk	0401.1000	40.0%	15.0%	17.0%	34.9%
	0401.2000				
	0401.3000				
Powdered Milk	0402.1000	40.0%	11.3%	17.0%	31.2%
	0402.2100				
	0402.2900				
	0402.9100				
	0402.9900				
Yogurt	0403.1000	90.0%	10.0%	17.0%	29.9%
	0403.9000				
Whey	0404.1000	30.0%	6.0%	17.0%	25.9%
	0404.9000				
Butter & Dairy Spreads	0405.1000	15.0%	12.2%	17.0%	32.1%
	0405.2000				
	0405.9999				
Cheese	0406.1000	90.0%	12.0%	17.0%	31.9%
	0406.2000				
	0406.3000				
	0404.4000	90.0%	15.0%	17.0%	34.9%
	0404.9000	90.0%	12.0%	17.0%	31.9%

Source: China Customs

END OF REPORT